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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 1271

THE P. DOUGHERTY COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND MOTION TO DEFER CONSIDERATION OF THE APPLICATION FOR THE WRIT.

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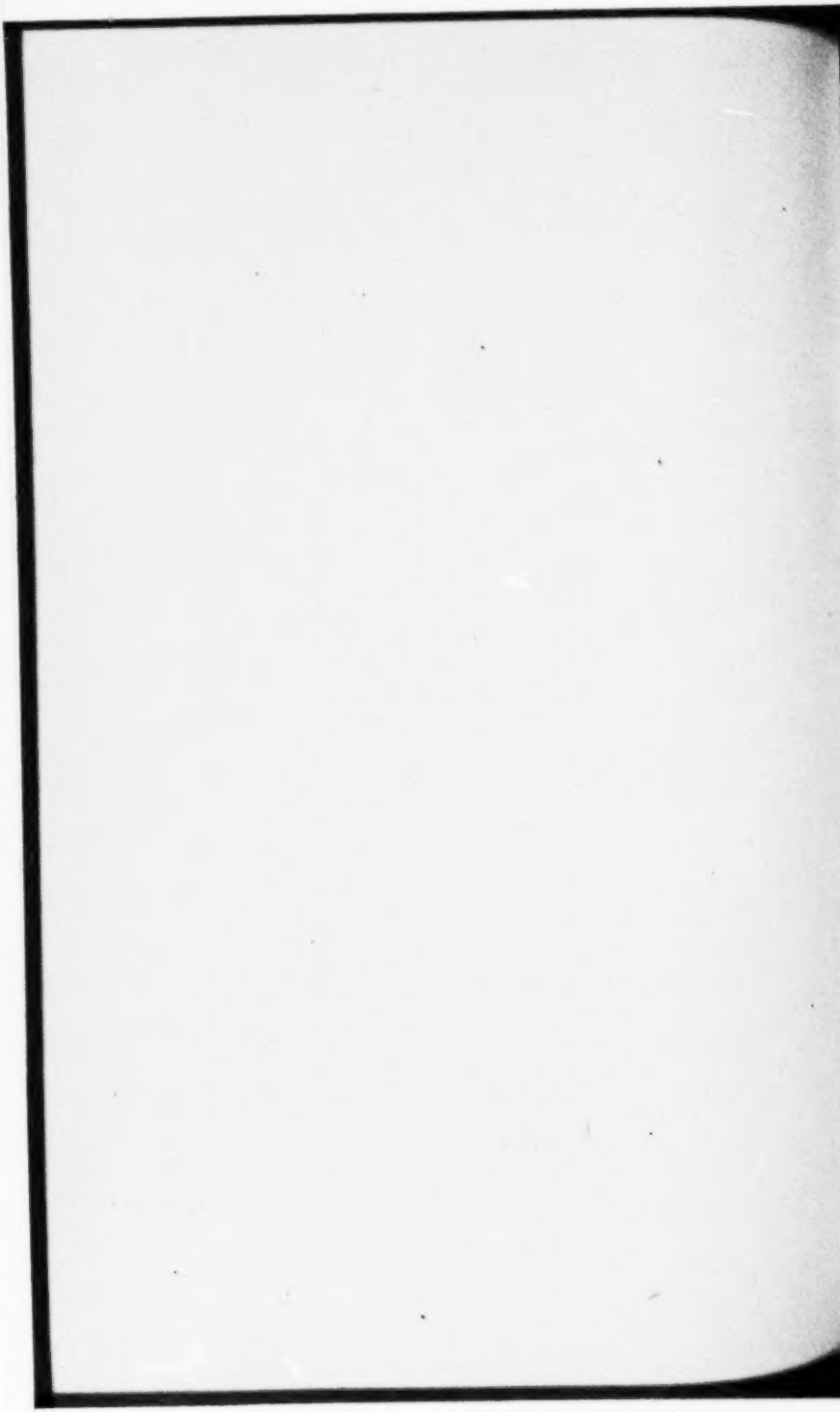

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 1271

THE P. DOUGHERTY COMPANY, A CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioner, The P. Dougherty Company, a Maryland corporation, prays that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit, entered December 23, 1946, (R. 24) 4 Cir. 159 F. 2d 269, affirming the decision of The Tax Court of the United States, 5 T. C. 791, redetermining deficiencies in income and excess profits taxes and a penalty imposed by the respondent for the fiscal year ended February 28, 1943 (R. 3, 21).

The certified transcript of the record in this case, including the proceedings in the Circuit Court of Appeals, is furnished herewith in accordance with the requirement in Rule 38, Paragraph I, of the Rules of this Court.

Jurisdiction

The judgment of the Circuit Court of Appeals for the Fourth Circuit was entered December 23, 1946 (R. 24). Time in which to apply for certiorari was extended to April 21, 1947 by the Chief Justice (R. 43). The jurisdiction of this Court is invoked under section 240 of the Judicial Code, as amended, section 347 of title 28 of the United States Code, and under sections 1141 and 1142 of the Internal Revenue Code (53 Stat. 164, 165).

Summary Statement of the Matter Involved

The petitioner acquired seven wooden barges during the period from 1915 to 1918, seven additional barges in 1921 and two steel tugs in 1923, at the total cost of $1,141,620.26. The tugs and barges were new when acquired.

From 1922 to the end of 1940 the tugs and barges were for long periods of time idle and not actually used in the petitioner's business. The tugs were idle continuously from 1930 to the latter part of 1941. They were moored to a dock at Norfolk. Three of the barges were tied up in the James River in 1930 and were never returned to use. The other barges were tied up a part or most of the time. The tugs and the three barges were continuously out of use for more than ten years.

In its returns for the several years prior to the fiscal year ended February 28, 1942, the petitioner entered as a deduction depreciation computed at 5% per annum on the tugs and barges not in use. The returns were nontaxable and were never audited by the respondent and the deduc-

tions for depreciation, taken on property not in use, were not disallowed by the respondent. In the preparation of its income and declared-value profits tax return for the year ended February 28, 1942, and for the purpose of determining whether to file an excess profits tax return on Form 1121, the petitioner sought to restore to cost the amount of the deductions so entered for exhaustion, wear and tear in the prior year returns for the periods during which the tugs and barges had been taken out of use.

The respondent determined that the several vessels, whether or not in use, were subject to depreciation at the rate of 5%, and found that the tugs and barges had become fully depreciated before the beginning of the taxable year February 28, 1943. The Tax Court upheld the determination made by the respondent and the court below affirmed the Tax Court holding that it is sufficient that the tugs and barges "were devoted to the trade or business" (R. 27).

The wood in the stern of one of the barges had rotted and had to be replaced at the cost of $17,593.32. The petitioner deducted the amount as expended for the repair to the vessel. The Tax Court held the expenditure not deductible, relying on section 24 of the Internal Revenue Code, entitled "Items Not Deductible," in which there is the provision that no deduction shall be made for:

> (3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made.

The Tax Court made the finding that the wood had rotted and had to be replaced. The finding is:

> During 1942 petitioner expended $17,593.32 to replace the stern of the Barge Maryland. It was found that much of the woodwork had rotted and had to be torn out and replaced (R. 12).

The Tax Court made no finding that the expenditure was for a betterment or improvement and, most important, made no finding that "an allowance is or had been made."

The court below held simply that the work done was in the nature of "a permanent betterment or restoration than a recurrent repair or upkeep" (R. 29).

The respondent computed the excess profits tax on the basis of the equity invested capital, defined in section 718 of the Revenue Act of 1940, 54 Stat. et seq., section 718 of the Internal Revenue Code, to include:

> The accumulated earnings and profits as of the beginning of such taxable year.

In his computation the respondent determined the amount of the earnings and profits at the beginning of the taxable year by applying the provision in section 113(b)(1)(B) of the Code that, in determining gain or the deduction for depreciation, all depreciation allowed in excess of the amount allowable in prior years should be deducted in determining the amount of the earnings and profits.

The petitioner contended before the Tax Court and in the court below, that the Congress has not defined, but has left to the courts the determination of the meaning of the "accumulated earnings and profits," as so stated in section 35.718-2 of Treasury Department Regulations 112. The petitioner contended that section 113(b)(1)(B), expressly made applicable to the determination of gain and of the deduction for depreciation, but not made to apply to the determination of the amount of the accumulated earnings and profits by the Congress, should not be so applied by the courts. The petitioner contended that section 718(a)(4) contemplates the use of the true earnings and profits, relying on *Willcutts* v. *Milton Dairy Company,* 275 U. S. 215.

The petitioner timely filed its return of the corporation income and declared value excess profits taxes on Form

1120 and reported a net loss. The petitioner did not file the excess profits tax return on Form 1121. The respondent asserted the 25% penalty for failure to file the return on Form 1121, which assertion the Tax Court and the Circuit Court of Appeals upheld. Five members of the Tax Court dissented, following the decision of this Court in *Spies* v. *United States,* 317 U. S. 492 (R. 18).

In the year 1945 the petitioner operated at a net loss, which it claims it is entitled to carry back to prior years, resulting in an unused excess profits tax carry-back to the year ended February 28, 1943, under section 710(c)(3) of the Internal Revenue Code. After the entry of the judgment by the Circuit Court the petitioner moved to remand for a new trial to permit the petitioner to prove the amount of the unused excess profits credit carry-back to which it is entitled. The Court of Appeals denied the motion without prejudice to proceed to prosecute a claim for refund (R. 40).

The Statutes and the Appropriate Regulations

In each of the revenue acts and in each of the Treasury Department regulations, the allowance of the deduction for exhaustion, wear and tear is limited to property used in the taxpayer's trade or business. In the Revenue Act of 1916, 39 Stat. 759, the provision was made "its use or employment in the business or trade." In section 214(a)(8) of the Revenue Act of 1918, 40 Stat. 1067, the provision is:

> A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business * * *.

This provision has been re-enacted without change in all subsequent acts until the enactment of the Revenue Act of 1942, in which the provision was restated as:

> A reasonable allowance for the exhaustion, wear and tear * * *

(1) of property used in the trade or business, or
(2) of property held for the production of income.

In Regulations 45, Article 162, for the enforcement of section 214(a) (8) of the Revenue Act of 1918, the requirement for the allowance of the deduction for depreciation was:

> The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business.

This requirement has been inserted without change in all subsequent income tax regulations. See Regulations 103 and 111, section 29.23(1)-2 in which there is the further provision, repeated from prior regulations:

> The necessity for depreciation arises from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of that nature.

The right to claim the deduction for a repair is not by virtue of a specific grant, but is allowed as a business expense under section 23(a) (1) of the Internal Revenue Code, which is that "there shall be allowed as deductions:

> All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *."

The provision in section 24(a) (3) of the Code, cited by the Tax Court, is that an expenditure to restore property or to make good its exhaustion, is not deductible, if an allowance therefor "is or has been made".

The equity invested capital under section 718(a) (4) of the Revenue Act of 1940 as amended shall be the sum of the money and property paid in, certain stock distributions, and:

> The accumulated earnings and profits as of the beginning of such taxable year.

In section 35.718-2 of Regulations 112, relating to the determination of the equity invested capital, the statement is made:

> The term "accumulated earnings and profits" is not defined in the Internal Revenue Code.

The definition of the equity invested capital in section 718 of the Revenue Act of 1940 does not differ from the definition of invested capital in section 326 of the Revenue Act of 1918, which included:

> Paid in or earned surplus and undivided profits • • •

In article 838 of Regulations 45 for the enforcement of section 326 of the 1918 Act there was the provision:

> Only true earned surplus and undivided profits can be included in the computation of invested capital, and if, for any reason, the books do not properly reflect the true surplus, such adjustments must be made as are necessary in order to arrive at the correct amount.

And in Article 839 of the same regulations, there is the provision that:

> Adjustments in respect of depreciation or depletion in prior years will be made or permitted only upon the basis of affirmative evidence that, as at the beginning of the taxable year, the amount of depreciation written off in prior years was insufficient or excessive as the case may be.

The provision in section 291 of the Code, in the case of any failure to file a return, is that the penalty defined therein shall be imposed "unless it is shown that such failure is due to reasonable cause and not due to willful neglect".

The Questions Presented

1. Were the several tugs and barges, during the periods of time when permanently tied up at the dock in Norfolk or in the James River, "used in the trade or business" and subject to exhaustion, wear and tear, within the meaning of the provision of the several applicable revenue acts that there should be deducted from gross income "a reasonable allowance for exhaustion, wear and tear of property used in the trade or business", so as to have become fully depreciated prior to the beginning of the taxable year?

2. The meaning of the provision in subsection (a) (3) of section 24 of the Code, that an expenditure to restore property or to make good its exhaustion is not deductible, if "an allowance is or has been made". If no allowance "is or has been made", is the cost of a mere restoration deductible?

3. In the computation of the invested capital under section 718 of the Code, are earnings and profits at the beginning of the year to be reduced by the amounts of excessive depreciation deducted in returns in prior years? Or is the true surplus to be used as under the Revenue Act of 1918?

4. Should the 25% penalty be imposed for failure to file the excess profits tax return for the fiscal year ended February 28, 1943?

Reasons for Allowance of the Writ

The writ should be granted to review the decision of the court below, because that court has attempted to change the express wording of section 23(1) of the Internal Revenue Code, has failed to consider the full meaning of section

24 and has decided the issues with respect to the computation of the equity invested capital and the imposition of the penalty contrary to decisions of this Court.

I

The Allowance for Exhaustion, Wear and Tear

The provision in section 23(1) is that in order to be deductible the allowance for the exhaustion, wear and tear of property, must result from its use in business. The wording of the section is "used" in the trade or business. The Treasury Department regulations have uniformly provided that the deduction is "limited to property used in the taxpayer's trade or business." These regulations have by now become recognized as having the force of law. *Becker* v. *Anheuser-Busch, Inc.*, 8 Cir., 120 F. 2d 403, cert. denied 314 U. S. 625, 62 S. Ct. 105.

In *Loewers Gambrinus Brewery* v. *Anderson*, 282 U. S. 638, 51 S. Ct. 260, this Court stated that the cost of plant depreciation "is a part of operating expenses necessary to carry on the manufacturing business". In *Buckwalter* v. *Commissioner*, 6 Cir. 61 F. 2d 571, the court stated:

> Only that which is directly employed in carrying on a trade or business falls within the statutory definition.

The petitioner tied up three barges in 1931 which were never returned to use. The two tugs were tied up and not used at all from early in 1931 until the close of 1941 (R.—). The facts here do not differ from those in *United States* v. *Real Estate-Land Title and Trust Company*, 3 Cir. 102 F. 2d 582, affd., 309 U. S. 13, 60 S. Ct. 371, in which a title company had acquired the plants of other companies and closed them. In denying the taxpayer's claim to obsolescence the Third Circuit stated:

> Deductions from gross income cannot be made for obsolescence or depreciation of property unless used

> in the trade or business of the taxpayer in the taxable year in question.

The decision of this Court and of the Third Circuit in the *Real Estate-Land Title* case are reviewed and followed in *Becker* v. *Anheuser-Busch Inc.*, 8 Cir., 120 F. 2d 403. In *Taylor* v. *Commissioner*, 3 Cir., 51 F. 2d 915, cert. denied 284 U. S. 689, the Court held:

> It is the use in the trade or business of "property" that entitles the taxpayer to a deduction. Unless property is used, no deduction is allowable.

In *Helvering* v. *Owens, et al.*, 305 U. S. 468, Mr. Justice Roberts stated:

> The income tax acts have consistently allowed deductions for exhaustion, wear and tear, or obsolescence only in the case of "property used in the trade or business".

The court below held, contrary to the express statutory provision and contrary to the decisions of this Court and of the other Circuit Courts of Appeals, that it is sufficient that the above-mentioned tugs and barges "were devoted to the trade or business which we think was sufficient to bring them within the statutory phrase", following *Kitteredge* v. *Commissioner*, 2 Cir., 88 F. 2d 632 (R. —). The court refused to follow *Helvering* v. *Owens, et al.* and other decisions cited in the note at page 27 of the record, despite the fact that the Tax Court had found that the tugs and barges were so tied up and not in use for more than a ten year continuous period.

It is submitted that the court below has erroneously decided a question of great importance, as the numerous decisions cited in its opinion clearly indicate. It is also submitted that in order to arrive at the conclusion reached the court did not follow the language of the statute, but gave

it a meaning not intended by the Congress in holding that property need not be used in business to entitle the taxpayer to the deduction for depreciation but need merely be devoted to the business. The decision is a clear departure from the wording of the statute. It is not for the court to substitute its definition or requisite for that stated by the Congress. The words "used" and "devote" have entirely different meanings as to the exhaustion of property.

II

The Cost of the Restoration of Property

The Tax Court held that the cost of restoring woodwork that had rotted in the Barge Maryland was not deductible as a repair as an ordinary and necessary business expense under section 23(a) (1) of the Code, because inhibited by section 24(a) (3) which provides that such cost shall not be deducted if an allowance therefor "is or has been made". The Tax Court made not such finding of fact. The Circuit Court of Appeals affirmed the Tax Court and also relied on the provisions of section 24, but based its conclusion on the fact that the restoration would last more than the taxable year. The decision is in conflict with that of the Fifth Circuit in *Zimmern* v. *Commissioner*, 5 Cir., 28 F. 2d 769, in which the cost of restoring a barge that had been sunken was allowed as a repair. The barge was merely, as here, restored to its original condition without any addition, improvement or betterment. The comment of the court below that the restoration of the stern of the barge did not differ from the enlargement of the hatches, clearly discloses an erroneous conclusion.

The writ should be granted as to this point, not so much because of the error of the court below, as because of the importance and the necessity to state the meaning of the provision in section 24(a) (3) that the cost of a restoration

is deductible or not dependent on whether or not an allowance for the cost "is or has been made".

III

THE COMPUTATION OF THE EQUITY INVESTED CAPITAL. ACCUMULATED EARNINGS AND PROFITS.

The Congress has provided, in section 718(a)(4) of the Revenue Act of 1940, that, for the purpose of the computation of the excess profits tax on the invested capital basis, there shall be included in the equity invested capital "The accumulated earnings and profits as of the beginning of such taxable year". The Congress has not stated the meaning of earnings and profits nor has the Congress provided the method by which they are to be determined. This has been recognized by the Treasury Department in its Regulations 112, section 35.718-2. The Congress has not provided that the provisions of section 113(b)(1)(B) shall be followed in the determination of such earnings and profits, but has left the meanings of the words for determination by this Court. Because of this the writ should be granted.

The petitioner submits that the court below erred in holding that the earnings and profits are to be determined by deduction therefrom all depreciation that had been allowed in prior years, as required by section 113(b)(1)(B) for the determination of gain or of the deduction for depreciation, to which alone it is made applicable.

In the Revenue Act of 1918 the Congress in section 326, in terms having the same meaning as in the Revenue Act of 1940, provided that the invested capital should include "earned surplus and undivided profits" at the beginning of the year. The Treasury Department promulgated Regulations 45, articles 838 and 839, that the Congress meant the "true earned surplus and undivided profits" and that

adjustments of depreciation taken in prior years should be made in order to arrive at the true earnings and profits. Section 326 of the 1918 Act was before this Court in *La Belle Iron Works* v. *United States*, 256 U. S. 377, and *Willcutts* v. *Milton Dairy Company*, 275 U. S. 215. In the latter case this Court held that the statute was correctly interpretated in the regulations, and that the words "surplus and undivided profits" are commonly "employed in corporate accounting" to denote "an excess in the aggregate value of all assets of a corporation over the sum of all its liabilities".

The decision of the Circuit Court of Appeals is in conflict with the decisions of this Court, interpreting a similar statutory provision, and, the petitioner submits, the writ should be granted for that reason. The question is of importance in that it should affect most corporations that are required to use the invested capital method for the determination of the excess profits tax.

THE IMPOSITION OF THE PENALTY FOR FAILURE TO FILE RETURN

Under section 729 of the Revenue Act of 1940 a corporation was not required to file an excess profits tax return on Form 1121, unless its net income exceeded the sum of $5,000. The petitioner determined, following the decision in *Pittsburgh Brewing Company* v. *Commissioner*, 3 Cir., 107 F. 2d 155, that its operations were at a loss and proceeded to file its income tax return but did not file an excess tax return. This Court had then not decided *Virginian Hotel Corporation* v. *Helvering*, 319 U. S. 523.

In its majority opinion the Tax Court held that the petitioner had not shown that the failure to file the return was not due to reasonable cause within the meaning of section 291 of the Code. Five judges of the Tax Court, including Judge Smith before whom the case was tried, dissented and based their dissent on *Spies* v. *United States*, 317 U. S. 492 (R. 18).

In not filing the return the petitioner stood on what it considered its legal rights under the decision of the Third Circuit Court of Appeals in the *Pittsburgh Brewing Company* case. Was not the petitioner justified and was not there reasonable cause for its act? Does not the decision below give the statute an effect and purpose that this Court held in the *Spies* case that it should not have?

Conclusion

The petitioner submits that the Circuit Court of Appeals for the Fourth Circuit has decided important questions of public interest and that its decisions are in conflict with express provisions of the statutes and the appropriate regulations and with the several cited decisions of this Court. The petitioner prays that the writ be granted and that the court below be reversed.

THEODORE B. BENSON,
Counsel for Petitioner.

MOTION TO DEFER CONSIDERATION OF APPLICATION FOR WRIT

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioner, by its attorney, moves the Court to defer consideration of its application for the writ until such time as the Congress shall have acted on a bill now pending before it to amend section 113(b)(1)(B) of the Internal Revenue Code with respect to the required adjustment to the basis of property for depreciation allowed in prior years, and the petitioner states:

1. The bill, H. R. 1104, was introduced by Representative Hobbs January 20, 1947 and referred to the Committee on Ways and Means. A copy of the bill is attached.

2. Colin F. Stam, Chief of Staff, Joint Committee on Internal Revenue Taxation, has made his report on the bill to the Chairman of the Committee on Ways and Means and has suggested that the bill be taken up for consideration at such time as other equitable and technical adjustments are being considered. A copy of Mr. Stam's report furnished for the purpose is attached.

3. The petitioner believes that the Congress will at the proper time give favorable consideration to the bill, which would relieve the petitioner of all the tax in controversy.

WHEREFORE, the petitioner moves the Court to defer consideration of its application for the writ.

Respectfully,

THEODORE B. BENSON,
Counsel for Petitioner.

APPENDIX

80th Congress, 1st Session

H. R. 1104

IN THE HOUSE OF REPRESENTATIVES

JANUARY 20, 1947

Mr. Hobbs introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend section 113 (b) (1) (B) of the Internal Revenue Code with respect to the adjustment of the basis of property for depreciation, obsolescence, amortization, and depletion.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subparagraph (1) (B) of section 113 (b) of the Internal Revenue Code, entitled "Adjusted basis", is amended by inserting after the word "allowed" the words "as deductions in computing taxable net income and resulting in a reduction of the taxpayer's taxes" to cause the first sentence thereof to read as follows:

> "(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed as deductions in computing taxable net income and resulting in a reduction of the taxpayer's taxes (but not less than the amount allowable) under this Act or prior income-tax laws."

(b) The amendments made by this Act shall be applicable with respect to taxable years beginning after December 31, 1938.

(c) For the purposes of the Revenue Act of 1932 and all subsequent revenue Acts, the amendments made to the

Internal Revenue Code by section (a) of this Act shall be effective as if they were a part of each such revenue Act on the date of its enactment.

Cloin F. Stam
Chief of Staff
G. D. Chesteen
Asst. Chief of Staff

Congress of the United States

Joint Committee on Internal Revenue Taxation

Washington

March 17, 1947.

Honorable Harold Knutson, Chairman
Ways and Means Committee
House of Representatives
Washington, D. C.

Dear Mr. Knutson:

This is with reference to the letter addressed to you on March 3 by Representative Sam Hobbs, in which he asks your cooperation toward the passage of a bill, H. R. 1104, which he has introduced, relating to deductions for depreciation.

Mr. Hobbs' bill would add the words "as deductions in computing taxable net income and resulting in a reduction of the taxpayer's taxes" after the word "allowed" in section 113(a)(1)(B) of the Internal Revenue Code.

Under the present provisions, in computing the basis of property for the determination of gain or loss on a sale or other disposition, or for determining depreciation, etc., in subsequent years, the original cost or other basis must be reduced by the depreciation, amortization, depletion, etc., *allowed*, but not less than the amount *allowable*, in previous years. Thus, if in a previous year the proper rate of depreciation were 8 percent but the taxpayer had deducted (without correction by the Bureau of Internal Revenue) depreciation at the rate of 10 percent, the 10

percent "allowed" would be deductible now in computing the basis for determining gain or loss on a sale or for subsequent depreciation. On the other hand, if the taxpayer had deducted 7 percent when 8 percent would have been "allowable", the 8 percent that should have been deducted rather than the 7 percent actually deducted would now be deducted in computing the basis for subsequent tax determinations.

Some years ago there was considerable litigation over the question whether depreciation at excessive rates deducted in returns for prior years which indicated a net loss was in fact "allowed" if the deduction did not result in decreased taxes for the years of the deductions. In 1942, in its decision in Virginian Hotel Co. *v.* Helvering (319 U. S. 523), the Supreme Court decided that deductions for depreciation, etc., as shown on a return were "allowed" even though the return showed no net taxable income but a net loss, and even though the Commissioner had accepted the return without examination of the taxpayer's records and returns.

Mr. Hobbs' bill would apply to a situation where in previous years the taxpayer had deducted in his returns an amount of depreciation greater than would be required, if deducted each year, to recover the cost during the useful life of the asset; if, for example, the useful life being 20 years, he had deducted 10 percent instead of 5 percent of the cost. If the excess deduction offset taxable income and thus reduced his taxes for that year the error would stand, but if the excess deduction resulted in a net loss, and so did not have the effect of reducing his taxes for that year, only the correct amount, and not the excess, would be deducted from the original cost or other basis in determining the remaining cost yet to be recovered through subsequent depreciation deductions or to be used as the basis for determining gain or loss on a sale.

Mr. Hobbs' bill is based upon the principle that the current income taxes of a taxpayer should not be more than they otherwise would be because of an error made by the taxpayer in a prior year, from which he derived no tax benefit. There can be little criticism of such a principle

on general logical grounds. This principle is similar to that which led the Congress, in 1942, to provide that amounts collected currently as recoveries of bad debts, taxes, etc., deducted in a previous year should not be viewed as taxable if the previous deduction resulted in no tax benefit to the taxpayer (section 22(b)(12), added by section 116 of the Revenue Act of 1942). Although, in principle, Mr. Hobbs' bill may be acceptable, an important objection that might be raised is the administrative difficulty that would arise from putting it into practise. In view of the carry-back and carry-forward of net losses and unused excess profits credits during recent years, the determination of whether, and to what extent, excess depreciation resulted in a tax benefit might entail considerable reexamination of returns, revenue agents' reports, etc., and the recomputation of depreciation deductions over a long period of years might, in some cases, be a lengthy process.

Since there is considerable justification for the suggested change on equitable grounds, and since there has been a considerable demand for such a change by taxpayers, their attorneys, and tax experts generally, however, it may well be that the Congressional committees having jurisdiction will wish to suggest an amendment similar to that of H. R. 1104 at such time as various equitable and technical adjustments to the income tax structure are being considered.

The bill introduced by Mr. Hobbs makes the suggested change in procedure applicable to all taxable years beginning after December 31 1938. In general, Congress does not look with great favor on proposals for retroactive adjustments, since they lead to the redetermination of tax liabilities in cases otherwise satisfactorily settled. In any case, it would seem unwise to provide for retroactive application to years prior to those as to which, in general, deficiencies may be asserted or refunds claimed (three years from the due date of the return), since only a few taxpayers could benefit and many, equally worthy, would be denied relief. If such a bill as H. R. 1104 were to be passed now, for example, the great mass of taxpayers would be precluded from obtaining relief with respect to their tax liabilities for 1939, 1940, 1941, 1942, and 1943; whereas a

few taxpayers with tax liabilities for one or more of those years yet unsettled because of disputes, litigation, etc. could benefit.

I trust this analysis and comment will be helpful to you and to Mr. Hobbs.

Sincerely yours,

(Signed) COLIN F. STAM,
Chief of Staff.